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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

TRANSFERRING SELECTED POST OFFICE BOX SERVICE LOCATIONS TO THE COMPETITIVE PRODUCT LIST

Docket No. MC2011–25

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE

On May 13, 2011, the United States Postal Service submitted an application to the Postal Regulatory Commission requesting the transfer of Post Office Box service (PO Box service) at approximately 6,800 locations from the market dominant product list to the competitive product list (Request).[1] On June 10, 2011, David B. Popkin and the Public Representative filed comments on the Postal Service's Request.[2] The Postal Service hereby provides its reply comments.

The Public Representative's primary comment is that the customer response to the 25 percent price increase that the Postal Service implemented at the 49 competitive PO Box service locations in January, 2011, shows that the Postal Service exercises sufficient market power for PO Box service to be considered market dominant under section 3642.[3] The Postal Service has previously disclosed that, at the 49 competitive locations, 25 percent of customers whose service expired in the three months following

[1] Request of the United States Postal Service to Transfer Post Office Box Service in Selected Locations to the Competitive Product List, Docket No. MC2011-25 (May 13, 2011).
[2] Initial Comments of David B. Popkin, Docket No. MC2011-25 (June 10, 2011) ("Popkin Comments"); Public Representative Comments on Postal Service Request to Transfer Selected Post Office Box Service Locations to the Competitive Product List (filed June 10, 2011, revised June 13, 2011) ("Public Representative Comments").
[3] Public Representative Comments, at 3-5.

the 25 percent price increase chose not to renew,[4] compared to a non-renewal rate of 11 percent in the three months prior to the price increase.[5] Given that the Postal Service's price increase led to a customer non-renewal rate that is more than 10 percent higher than usual, it is plain that a substantial price increase has caused a significant portion of customers to stop using PO Box service.

However, the Public Representative points to the fact that the Postal Service was able to replace most of the lost customers with new customers and argues that, therefore, no business was lost. Since implementing the 25 percent price increase, the Postal Service has thus far been able to offset approximately 70 percent of non-renewing customers with new customers.[6] The approximately 30 percent of non-renewals that have not been replaced translate to a net customer loss of approximately 7.5 percent.[7] The Postal Service believes that this is a significant level of lost business.[8] Further, to the extent that the Postal Service has had success in replacing non-renewing customers, much of this success likely stems from the fact that the Postal

[4] Responses of the United States Postal Service to Questions 1–3 of Chairman's Information Request No. 1, Docket No. MC2011-25 (June 13, 2011) ("ChIR Response"), at response to Question 2.
[5] Request, at 4.
[6] Given that renewals and acquisitions occur regularly, and that an additional set of customers' service expires each month, this percentage fluctuates somewhat over time. As of today, the offset of non-renewing customers by new customers is approximately 70 percent.
[7] This percentage has been calculated by multiplying the 25 percent non-renewal rate by the 30 percent non-replacement rate. The 7.5 percent net loss figure would understate customer loss to the extent that additional customers terminate their service before the expiration of their service terms.
[8] The Postal Service recognizes that its Request did not specify precisely how much of the non-renewals was offset by new customers, and that this lack of specificity likely led the Public Representative to reach certain incorrect conclusions, such as the belief that there has been no net loss of business and the belief that the supply of boxes is limited or constrained.

Service has added service enhancements at some of the 49 competitive locations,[9] and that it has offered a "Baker's Dozen" pricing incentive to all new customers at these locations.[10] The Postal Service submits that, absent these service enhancements and pricing incentive, the net percentage of business lost would have been higher. To the extent that the Postal Service stops adding new enhancements to PO Box service, the rate at which new customers are attracted would be expected to decrease, leading to a larger net loss of customers for any subsequent price increases.

In a similar vein, the Public Representative argues that the Postal Service's ability to make up for much of its increased customer loss through new customers "reveals that the supply of available boxes is limited relative to the demand for boxes."[11] The Public Representative goes on to charge the Postal Service with having "effectively decrease[d] output by constraining the number of post office boxes," and asserts that "[t]here can be no other explanation for the Postal Service ability to replace most of the non-renewing customers with new customers."[12] As noted above, there is a straightforward explanation for the Postal Service's ability to sign up new customers: enhanced services and the new customer pricing incentive. Further, the vacant box rate at the 49 locations is 41.7 percent, demonstrating that the acquisition of new customers did not result from a limited supply of boxes.[13]

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[9] As noted in the Request, the Postal Service has expanded access hours and added a "signature on file" service at many of the locations. Request, at 9.
[10] The Baker's Dozen incentive gives the thirteenth month free to new customers paying for twelve months.
[11] Public Representative Comments, at 4.
[12] *Id*. at 5.
[13] The collective vacancy rate for the 6,800 locations represented by the Request and the 49 currently competitive locations is above 30 percent. The Postal Service cannot easily add or remove boxes without significant cost outlays.

Both the Public Representative and Mr. Popkin argue that, for current PO Box service customers, the transaction costs of switching to a private mailbox service provider (PMB) result in inelastic demand for PO Box service.[14] It is true that switching from PO Box service to a PMB involves some transaction costs. But switching to a different provider for any type of service involves transaction costs; it does not follow that existing customers' demand is necessarily inelastic.[15] As the Commission observed when it considered the transfer of the 49 locations to the competitive product list last year:

> Universally, transaction costs will be incurred anytime an existing customer opts for a new service provider. Whether the change is warranted is an individual choice based, in part, on balancing the tradeoffs involved.[16]

[14] Public Representative Comments, at 4. Popkin Comments, at 2. Puzzlingly, the Public Representative argues that demand from potential new customers is also inelastic, because "possible new customers must affirmatively act to obtain PO Box service—and pay for the delivery of mail that can be obtained for free from city delivery or rural carriers." Public Representative Comments, at 4. To the Public Representative, it follows that "both the specific need for PO Box service, as well as the cost and effort required to obtain such service, suggests that the demand of possible new customers for PO Box service is relatively inelastic." *Id.* The logic of the Public Representative's reasoning here is not apparent to the Postal Service. If, as the Public Representative observes, new customers already have a free alternative (carrier delivery), and if they must "affirmatively act" and take on additional costs to obtain PO Box service, then it would follow that new customer demand should be relatively price elastic. In other words, if prices were to rise too high, potential new customers would simply continue to use their free option of carrier delivery. Obtaining new customers through price changes would mean lowering prices, which is not the concern of 39 U.S.C. § 3642(b)(1).

[15] The Postal Service also notes that the Public Representative's focus on witness Lion's statement in Docket No. MC96-3 is misleading.

> Because of the relatively low fees for post office boxes, the decision to obtain box service is not driven primarily by price, but by specific needs and by convenience. This is corroborated by the fact that so many people are willing to pay much higher fees for CMRA boxes. Docket No. MC96-3, Rebuttal Testimony of Witness Lion, at 12.

Public Representative Comments, at 7. The above quote is limited to non-customers' decisions to "obtain" service, rather than the impact of price changes on existing customers. Further, given the regulatory and business changes that have ensued in the fifteen years since the statement quoted by the Public Representative, it would be reasonable for the Postal Service's understanding of the mailbox services market to have evolved.

[16] Order No. 473, Docket No. MC2010-20 (June 17, 2010), at 11.

Further, if the customer response to the 25 percent price increase at the 49 competitive locations described earlier shows anything, it is that existing customers' demand is decidedly price elastic.

Both the Public Representative and Mr. Popkin assert that PO Box service and the service provided by PMBs are fundamentally different services.[17] In support of their assertions, they point to the relative advantages that each option offers. For example, in regard to PO Box service, they point to the higher security of mail that does not leave the Postal Service network, and the potentially earlier availability of mail; Mr. Popkin also points to the availability of larger box sizes. For PMB service, they point to the ancillary services offered by PMBs, such as street addressing, notification when there is mail in a box, acceptance of items from private carriers, specific forwarding of mail, packaging services, outgoing services, and the availability of packaging supplies and greeting cards. Any differences between PO Box service and PMB service do not alter the fact that, on an essential level, both offer the same proposition – the ability to receive mail and parcels at an address other than an individual or business's street address, for a fee.[18] The Commission opined on this issue in Order No. 473:

> Notwithstanding the ancillary services offered by PMB providers, the two products are close substitutes for one another. The fundamental purpose of each is to serve as a paid receptacle for receipt of correspondence and packages sent to the addressee. Incidental differences in the services simply distinguish the products offered to the public. At bottom, each

[17] Public Representative Comments, at 6. Popkin Comments, at 3.
[18] To use a similar example, one would not argue that, to an individual looking to rent an apartment in a particular city, the various apartments available for rent in that city represent fundamentally different products and exist in fundamentally separate markets merely because there are differences among them (*e.g.*, location, amenities, etc.).

> product provides a means to accomplish delivery of correspondence and packages sent to addressees.[19]

Further, some of the differences cited by the Public Representative and Mr. Popkin do not even apply between some PO Box service locations and PMBs. For example, some PMBs make customers' mail available earlier than nearby PO Box service locations do, by using caller service to retrieve the mail earlier in the day. Similarly, many Post Offices sell packaging supplies and greeting cards. In regard to box sizes, many PO Box service locations themselves do not have the larger box sizes cited by Mr. Popkin. In addition, as indicated in the Request, the Postal Service already offers, at many competitive locations, certain enhancements similar to PMBs' ancillary services.[20]

The Public Representative offers one additional argument as to why PO Box service and PMB service should be considered fundamentally different services. The Public Representative observes that "[b]oth the Postal Service and PMB providers agree that prices for PO Box service are generally lower than PMB prices," and then suggests that, if PO Box service and PMB service really were close substitutes for one another, they "should exhibit undifferentiated prices."[21] To the Public Representative, "the existence of different prices suggests that PO Box service and PMBs are

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[19] Order No. 473, *supra* note 16, at 10.
[20] Request, at 7. Mr. Popkin argues that such enhancements "should apply equally to both Market Dominant boxes as well as Competitive boxes." Popkin comments, at 4. Unfortunately, in most cases, these enhancements involve significant implementation costs. As noted in the Request, the competitive price structure provides the flexibility needed to enhance box service at competitive locations. Request, at 7. The Postal Service generally would not be able to offer the same enhancements at market dominant locations without causing the market dominant PO Box service product to cease covering its costs.
[21] Public Representative Comments, at 5-6.

differentiated products that serve the same market."[22] The Public Representative ignores the more obvious explanation for the price differential, namely the statutory constraints on Postal Service pricing. For more than three decades, the Postal Service set prices based on a cost-of-service framework, as delineated in the Postal Reorganization Act of 1971. Beginning in 2007, the Postal Service has increased prices for market dominant products only to the extent allowed under a price cap tied to the change in the Consumer Price Index, pursuant to the Postal Accountability and Enhancement Act of 2006. In contrast, businesses in the private sector set prices based on supply and demand, generally with the goal of maximizing profit. These two approaches can result in vastly different prices for comparable products.

Both the Public Representative and Mr. Popkin question the Postal Service's use of the five mile metric to identify competitive PO Box service locations. In support of her opposition to the five mile metric, the Public Representative asserts that "proximity *per se* does not reveal anything about the nature of the competition, if any, between post office boxes and [PMBs]" (italics in original).[23] The Public Representative goes on to state that "proximity is not a sufficiently compelling factor governing consumer choice that overrides all other service features distinguishing PO Box service from PMBs," and that, "[c]onsequently, the Postal Service's focus on proximity is misleading for purposes of analyzing competition."[24] The Postal Service has discussed above why the service features distinguishing PO Box service from PMB service do not alter the fact that PO

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[22] Public Representative Comments, at 6.
[23] Public Representative Comments, at 6. To support this statement, the Public Representative cites a similar statement that the Public Representative made in Docket No. MC2010-20. It is not clear why the Public Representative's having made the statement previously should lend the statement any more credence now.
[24] *Id.*

Box service and PMB service are, on an essential level, the same service. In any retail industry, where two retail businesses offer the same basic service, proximity is perhaps the most useful criterion for determining whether the two businesses compete with each other for the same pool of customers. Similarly here, given that PO Box service locations and PMBs offer a comparable service, the Postal Service believes that the most useful criterion for determining whether a particular PO Box service location faces competition from PMBs is proximity.

Mr. Popkin challenges the five mile criterion on two bases. First, he states that the Request does not indicate why five miles was chosen.[25] The Postal Service has explained why it chose five miles as the appropriate distance for determining competitiveness in its response to Chairman's Information Request No. 1 in this docket.[26] Second, Mr. Popkin challenges the five mile criterion by way of example, stating that a PMB in Tenafly, New Jersey has over 30 postal locations within five miles, and asserting that the 30-plus offices have thousands of PO Box holders whose only competitive alternatives are a limited number of boxes at the Tenafly PMB.[27] The Postal Service has analyzed the Tenafly, New Jersey PMB referenced by Mr. Popkin and all of the PO Box service locations within five miles of that PMB. The Postal Service has been able to identify 29 PO Box service locations within five miles of the Tenafly PMB. Of these 29 locations, all are located within five miles of at least four PMBs; a majority (17) are located within five miles of at least six PMBs.[28] Thus, customers of the 29 PO Box service locations have ample competitive alternatives

[25] Popkin Comments, at 1.
[26] *See* ChIR Response, at response to Question 3.
[27] Popkin Comments, at 1.
[28] One is located within five miles of twelve PMBs.

available to them, and none of the 29 locations was included in the Request solely based on the existence of the Tenafly PMB.

The Public Representative and Mr. Popkin make a few other arguments that do not address the criteria for determining whether a product should be transferred to the competitive product list, but to which the Postal Service would nonetheless like to reply. The Public Representative states that "approval of the Postal Service's request to transfer 6,800 PO Box locations would permit the Postal Service to set the price for this product substantially above cost."[29] The Public Representative then performs a basic calculation and concludes that the transfer will result in a competitive PO Box service cost coverage of 178 percent. The Postal Service believes that the Public Representative's calculation is significantly overstated, because it incorrectly assumes that a 25 percent increase will not result in a significant net loss of business, incorrectly assumes that the Postal Service will institute a 25 percent price increase at all competitive locations,[30] and ignores the costs of implementing service enhancements. Moreover, the Public Representative's calculation, even if it were accurate, would not be an appropriate reason for denying the Request under the applicable statutory and regulatory provisions. The Postal Service has the ability to raise any competitive product's price above costs; that ability is a function of a product being on the competitive product list. It is a circular argument to assert that a transfer request should be denied because approving it would give the Postal Service the ability to raise prices

[29] Public Representative Comments, at 5.
[30] The Postal Service does not intend to make across-the-board pricing decisions for the approximately 6,800 locations represented by the Request. Some locations may experience price increases while others do not, and the levels of price increases may vary. Certain locations may in fact see price decreases; for example, in certain locations where the vacancy rate is extremely high, the Postal Service may decrease prices to entice new business.

above costs. In addition, given that certain products on the market dominant product list, for which the Postal Service has a monopoly, have cost coverages exceeding 178 percent, it is not clear what such a cost coverage figure (even if it were accurate) would prove.

Mr. Popkin states that factors within the Postal Service's control affect the competitiveness of PMBs; for example, the Postal Service controls the method and time of delivery of mail to a PMB, the provision of a blue collection box outside a PMB location, and the hours of collection at a blue collection box outside a PMB location. In regard to the method and time of mail delivery, a PMB can request caller service to obtain mail earlier than the scheduled carrier delivery, as many PMBs already do. In regard to blue collection boxes, the provision of blue collection boxes is strictly based on mail density tests. The Postal Service is not aware of any party having ever asserted, in this docket or in prior dockets, that the Postal Service has treated blue collection boxes outside of PMBs any differently than other blue collection boxes, despite the fact that the Postal Service should have had just as much incentive to do so in the past as it theoretically would after the approval of the Request. If unfair treatment of PMBs were ever to become a real concern, parties could petition the Commission for redress. In addition, it bears noting that, by suggesting that the Postal Service has an incentive to treat PMBs unfairly, Mr. Popkin has implicitly acknowledged that PO Box service is in competition with PMB service. If the two were fundamentally different services that were not in competition with each other, there would be no incentive for the Postal Service to treat PMBs unfairly.

In summary, the critical question before the Commission is whether the PO Box service locations represented by the Request compete with PMBs. The Postal Service believes that the information it has provided in this docket demonstrates that the PO Box service locations represented by the Request compete with PMBs. The Postal Service therefore asks that the Commission approve its Request.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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